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Bills Committee on Sale of Goods (United Nations Convention) Bill

Background brief

Purpose

This paper provides background information to facilitate members' consideration of the Sale of Goods (United Nations Convention) Bill ("the Bill"). It also summarizes the major views and concerns expressed by members of the Panel on Administration of Justice and Legal Services ("the Panel") related to the proposed application of the United Nations Convention on Contracts for the International Sale of Goods ("CISG") to the Hong Kong Special Administrative Region ("HKSAR") ("the Proposed Application").

Background

2. According to the Administration, CISG is an important and widely adopted Convention. It is a commercial law treaty which provides a set of uniform rules governing contracts for the international sale of goods within its scope, with the purpose of providing a modern, uniform and fair regime for contracts for the international sale of goods, thereby introducing certainty in commercial exchanges and decreasing transaction costs. As at the end of June 2021, there are 94 Contracting States to CISG ("Contracting States") from different legal traditions and at various levels of economic development, which represent over two-thirds of the global economy.

3. Under its Article 1(1)(a), CISG applies automatically to contracts for sale of goods between parties whose places of business are in different Contracting States. Under its Article 1(1)(b), CISG also applies to international sales contracts where the rules of private international law (of the forum) lead to the application of the law of a Contracting State. However, Article 95 of CISG provides that any State may declare that it will not be bound by Article 1(1)(b). Party autonomy is a fundamental principle of the Convention. With very limited

exceptions, the parties can, by agreement, derogate from or vary the effect of any provisions of the CISG, or exclude the Convention's application entirely (under Article 6). Whilst the People's Republic of China ("PRC") is a Contracting State to CISG, CISG is currently not applicable to Hong Kong.

4. On 27 May 2019, the Administration briefed the Panel about its plan to launch a three-month public consultation exercise on the Proposed Application by outlining the key issues and arrangements of the consultation.¹ The public consultation exercise was conducted from 2 March 2020 with the issuance of the paper titled "Proposed Application of the United Nations Convention on Contracts for the International Sale of Goods to the Hong Kong Special Administrative Region" ("the Consultation Paper"),² and extended to end on 30 September 2020. The Administration briefed the Panel on the public consultation exercise at its meeting on 25 May 2020 and consulted members' views.

5. The Administration briefed the Panel at its meeting on 22 March 2021 on major public views received in the public consultation, its response to the views and its recommended way forward regarding the Proposed Application as detailed in its submission to the Panel.³ A gist of the public response on the application is set out in paragraph 19 of the LegCo Brief on the Bill.

The Sale of Goods (United Nations Convention) Bill

6. The Bill was published in the Gazette on 9 July 2021 and received its First Reading at the Council meeting of 14 July 2021. It seeks to implement CISG (without China's reservation under Article 95) in Hong Kong with a view to enhancing Hong Kong's legal infrastructure for the international sale of goods and bolstering its role as an international hub for trade and dispute resolution. The Administration has sought the support of the Central People's Government ("CPG") for the Proposed Application. After enactment of the Bill, the Administration may seek CPG's assistance in completing the necessary steps for the application of the CISG to Hong Kong pursuant to Article 153 of the Basic Law.

Major views and concerns of the Panel on Administration of Justice and Legal Services

7. The major views and concerns of members raised at the Panel meetings on 27 May 2019, 25 May 2020 and 22 March 2021 are summarized in the ensuing paragraphs.

Contracting States

8. Members queried why CISG was not applicable to Hong Kong for years, while many of its trading partners had become the Contracting States. The Administration explained that prior to 1 July 1997, CISG was not applied to Hong Kong because the United Kingdom ("UK") was not a Contracting State. During and after the transition, PRC had not deposited notification with the Secretary General of the United Nations for applying CISG to Hong Kong though PRC is a Contracting State.

9. In response to members' enquiries, the Administration advised that among the major common law jurisdictions, the United States, Australia, New Zealand and Canada were Contracting States. While CISG was not adopted by UK, the Administration advised that CISG might still be applicable in UK for cases to be resolved by means of arbitration if both parties to the contract agreed to its adoption. As for other common law jurisdictions, there were states who were parties to CISG such as Singapore, and those who were not, e.g. India. Members were informed that CISG had been applied in about half of the countries participating in the Belt and Road Initiative.

Benefits to Hong Kong and the legal profession

10. In response to members' queries about the benefits of the Proposed Application to Hong Kong and the legal profession, the Administration replied that based on its initial assessment, the benefits included the potential to drive Hong Kong's Gross Domestic Product and trade growth, preventing Hong Kong businesses from being subject to unfamiliar foreign laws when entering into cross-boundary transactions, improving Hong Kong's competence in resolving CISG disputes and providing freedom of contract.

11. The Administration further advised that, given the uniform CISG rules and the relatively long history of CISG, which had entered into force in 1988, it was hoped that fewer disputes would arise between parties who had been familiar with the CISG rules. It was also hoped that, when such disputes arose, they could be resolved efficiently as the United Nations Commission on International Trade Law was maintaining a database with large number of CISG cases for reference. Some members agreed to the benefits of having a set of uniform and mutually-agreed rules for parties to the arbitration, as a popular means for international commercial dispute resolution, to proceed with.

12. In terms of potential benefits to the legal profession, the Administration advised that as CISG cases might often be resolved by means of arbitration, the application of CISG to Hong Kong could provide an opportunity to further enhance its status as an international legal and dispute resolution services centre. Moreover, the application of CISG to Hong Kong and implementation in Hong

Kong law might benefit the legal profession by increasing the opportunities for Hong Kong lawyers from the perspective of advising on relevant trade contracts and dispute resolution.

13. Some members questioned whether the application of CISG to HKSAR would weaken the demand for Hong Kong legal services, as it was proposed in the Consultation Paper that by applying a neutral and visible set of rules to the transactions between parties from different members of the CISG, Hong Kong businesses would obtain a benefit from reduced transaction costs in the event that a dispute arose from the contracts by avoiding having to obtain legal advice on foreign law and retain foreign litigators.

14. In response, the Administration said that after the application of CISG to HKSAR, the legal profession with sufficient familiarization with the CISG rules would still play an important role in matters relating to contracts for the international sale of goods. As the autonomy of the parties to international sales contracts was a fundamental theme of CISG, the parties could, by agreement, derogate from or vary the effect of the any CISG rules subject to an exception and decide the contractual terms based on the circumstances of individual contracts. Furthermore, it was envisaged that there might still be a certain amount of contractual disputes based on the experience and precedents of other Contracting States. In view of the above, it was considered that the support and advice from the legal profession would be indispensable.

Comparison and potential conflicts between CISG and Hong Kong law

15. In response to members' enquiries regarding whether there was any potential conflict between CISG and Hong Kong law, in particular the Sale of Goods Ordinance (Cap. 26), and how they could be overcome, the Administration replied that a systematic analysis had been conducted by the Administration as detailed in Chapter 2 of the Consultation Paper to compare CISG and Hong Kong law. The conclusion, which was generally accepted by the parties consulted, was that compatibility did not pose a strong argument against the application of CISG to HKSAR. Comparing to the common law, CISG was relatively more pro-contract in the sense that its policy was to keep the contract alive rather than allow for easy termination, unless there was a fundamental breach.

16. The Administration further explained that in accordance with Article 25 of CISG, a breach was fundamental if it resulted in such detriment to the other party as substantially to deprive him of what he was entitled to expect under the contract. By comparison, under the common law, it would be easier for a party to the contract to go for its termination if there was a breach in any condition(s). Furthermore, CISG was the result of collaboration among members of the United Nations Commission on International Trade Law, which was by no

means an easy task since these members were coming from common law as well as civil law jurisdictions. Furthermore, with 94 Contracting States having adopted CISG currently, including about half of the Belt and Road countries, the application of CISG to HKSAR would assist in promoting external trade and decreasing transaction costs.

"Opting-in" or "Opting-out" as the default position

17. Members noted that, in response to the public consultation conducted by the Administration, the Hong Kong General Chamber of Commerce ("HKGCC") had expressed reservation on the Proposed Application with particular concerns about the proposed imposition of CISG rules as a default position, i.e. to change the current "opt-in" position to an "opt-out" position. In view of the above, members queried how Hong Kong businesses would be better off with the current "opt-in" position changed to the "opt-out" position assuming that CISG would be applied to Hong Kong. Some members also pointed out that, as reported in the Consultation Paper, there were high exclusion rates of CISG rules in certain Contracting States. They cast doubt on the effectiveness of CISG in reducing transaction costs.

18. In response, the Administration pointed out that the prime difficulty with maintaining the status quo, i.e. maintaining the "opt-in" position, was that a Hong Kong business could not effectively create a contract which was governed by CISG and possibly also Hong Kong law, and CISG could not be used as originally designed. The Administration then referred to an argument bought in by HKGCC against the application of CISG to HKSAR that, if CISG rules were adopted as a default, any deviation from CISG rules would require the other party's agreement and if the other party was unwilling to do so, the Hong Kong business would have no option but to accept CISG rules or refuse to buy or sell the goods in question.

19. In response to that argument, the Administration explained that the question of choice of law for a sale of goods contract was largely a question of agreement by parties and a matter of commercial decision, to which the bargaining power of the respective parties would be an important factor. As such, even if the status quo was maintained, Hong Kong businesses would possibly face the same scenario mentioned above since they were transacting with counterparts from all over the world and the difficulties in agreeing on the governing law of the contract would still linger.

20. The Administration considered that the automatic application of CISG to HKSAR would have the attraction that, when a party to a contract had difficulties in convincing the other to accept its preferred choice of law clause, Hong Kong businesses would have an additional choice of law option, i.e. the uniform and neutral CISG if it had been applied to Hong Kong, to put on the

negotiation table. CISG would give parties to the contract the freedom to derogate from or vary the effect of any its provisions as well as the freedom to exclude CISG in its entirety in accordance with their agreed commercial decision.

Reservation under Article 95 of CISG

21. Members noted that CISG was applicable to contracts for sale of goods between parties whose places of business were in different States when the rules of private international law led to the application of the law of a Contracting State, but several Contracting States (e.g. PRC, Singapore and the USA) had declared under Article 95 of CISG that they were not bound by this ground as permitted by CISG. The Administration explained that under its Article 1(1)(b), CISG applied to a contract when one of the parties or both were not Contracting States but had chosen the law of a Contracting State, say Canada, to govern the contract. However, since PRC had made a declaration pursuant to Article 95 of CISG that it was not bound by Article 1(1)(b) of CISG, CISG would not apply automatically to the contract if one of the parties was from PRC.

22. According to the Administration, it was proposed in the Consultation Paper that the above reservation be extended to Hong Kong. However, having carefully considered the pros and cons of the initial proposal on this issue and in the light of the public responses received, it planned to apply the CISG without China's Article 95 reservation to Hong Kong. Hence, for Hong Kong, CISG would also apply to international sales contracts where the rules of private international law lead to the application of the law of a Contracting State.

The Mainland-Hong Kong sales transactions issue

23. At the Panel meeting on 22 March 2021, some Panel members expressed disappointment with the Administration's plan to remove clause 4(2) of the draft Bill as set out in Annex 4.1 of the Consultation Paper, which sought to implement the unilateral application-approach proposal of applying CISG rules also to the contracts for the Mainland-Hong Kong sales of goods. They enquired about the Administration's timetable for initiating discussion with the CPG regarding the Proposed Application to negotiate with the Mainland an arrangement for the mutual application of CISG provisions to Mainland-Hong Kong sales transactions.

24. In reply, the Administration said that it fully recognized the importance of the matter and the aforementioned concerns expressed. At the same time, it was also aware that Mainland-Hong Kong sales transactions were transactions within the same country and CISG, being an international convention governing international sale of goods, would not apply. According to the Administration, there was a view gathered during the public consultation that a bilateral-

arrangement-approach might be a better way to ensure the reciprocal applicability of CISG rules in the case where the parties adopt the PRC law. Having regard to this view, the Administration considered it prudent to go for the reciprocal applicability of CISG between both sides through discussions with the Mainland, which might take some time to conclude.

25. In response to some members' enquiries, the Administration advised that if CISG was applicable to Hong Kong/Mainland transactions, the parties to a contract could opt out of CISG and choose either the Mainland law or Hong Kong law to govern the contract concerned. It added that the contractual parties could also choose the laws of other countries, e.g. UK, as the governing law of the contract.

Latest position

26. At the House Committee meeting on 16 July 2021, members agreed to form a Bills Committee to scrutinize the Bill.

Relevant papers

27. A list of relevant papers is in the **Appendix**.

Bills Committee on Sale of Goods (United Nations Convention) Bill

List of relevant papers

Meeting	Date	Item	LC Paper No.
Panel on Administration of Justice and Legal Services	27.5.2019 (Item III)	<u>Administration's paper</u>	CB(4)908/18-19(03)
		<u>Minutes of meeting</u>	CB(4)1224/18-19
	25.5.2020 (Item VI)	<u>Background brief</u>	CB(4)583/19-20(06)
		<u>Public consultation paper by the Administration</u>	CB(4)572/19-20(01)
		<u>Executive summary of the public consultation paper by the Administration</u>	CB(4)572/19-20(02)
		<u>Minutes of meeting</u>	CB(4)872/19-20
	22.3.2021 (Item III)	<u>Administration's paper</u>	CB(4)648/20-21(03)
		<u>Background brief</u>	CB(4)648/20-21(04)
-	7 July 2021	<u>LegCo Brief</u>	SF(37) TO CPA 272/00C
-	9 July 2021	<u>The Bill</u>	-
-	15 July 2021	<u>Report by the Legal Services Division</u>	LS93/20-21